# Seattle City Light Rates

Workshop on Revenue Requirements
and Financial Policies

March 17, 2005

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# 2006 Revenue Requirements

| | (million $) |
|---|---|
| Purchased Power | 287 |
| Operating Exp & Tax | 211 |
| Debt Service | 137 |
| Misc Revenue | (32) |
| Whlsl Rev less Variability Allowance* | (28) |
| **Revenue Requirement** | **575** |
| | |
| *Avg wholesale revenue is $133 million. | |
| Variability allowance is $105 million. | |

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# Variability Allowance

- Net Wholesale Revenue varies because of
  - hydrological conditions
  - market prices
  - retail load
    - (higher retail sales mean lower wholesale sales)
- Retail Revenue varies because of
  - temperature (heating and cooling loads)
  - economic conditions
- Set variability allowance so that 95% of the time results are better than those you've counted on.

# Capital Financing: 2006

| | | | | | |
|---|---|---|---|---|---|
| (million $) | | | | | |
| | | | | | |
| **Capital Spending** | **179** | | | | |
| *CIP* | *143* | | | | |
| *Conservation* | *21* | | | | |
| *High Ross & Other* | *15* | | | | |
| | | | | | |
| **Capital Financing** | | | | | |
| x% Exceedence* | Installation Charges & Reimbursements | Current Net Revenue | Debt | | % Debt Financing |
| 95% | 32 | **-** | 147 | | **82%** |
| 75% | 32 | 53 | 94 | | 53% |
| 50% | 32 | **105** | 42 | | **23%** |
| 25% | 32 | 136 | 11 | | 6% |
| 5% | 32 | 207 | (60) | * | 0% |
| | | | | | |
| * Cash flow is better than this x% of the time | | | | | |
| * Negative borrowing represents retirement of debt or build-up of operating cash balances. | | | | | |

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# Financial Policy Issues

- Variability allowance
- Reserves
  - Meeting the Bond Reserve Requirement
  - Creating and Funding a Contingency Reserve
  - Specifying how a Contingency Reserve may be used and replenished
- Debt/Capitalization Ratio

# I. Variability Allowance

# Current Policy

- Set rates so that bottom line in flow of funds is greater than zero 95% of the time
  - Takes into account variability of water conditions, market prices and system load
  - 95% of the time net revenue available for capital will be greater than zero
  - On the average in 2006 it would be $105.4 m

# Effect of Current Policy

- Rate Stability
  - Reduces the need for emergency rate increases when wholesale revenue is low
- Debt Reduction (assuming wholesale revenue at expected level)
  - Funds over 50% of capital from current revenue
  - Debt level falls by $300.6 m from 2004 to 2016
  - In 2016 debt is 43% of capitalization

# Alternatives to 95% Confidence

- Set variability allowance at lower level of confidence: e.g., 90%.
- Effects:
  - Revenue requirements lowered by $17.9 m in 2006
  - Revenue financing of capital is lower, debt increases $35 m from 2006-2012 and is $188 m higher in 2016 than under proposed policy
  - Less downside protection against unfavorable water conditions, market prices, etc.

# II. Reserve Policy: Bond Reserve and Contingency Reserve Account (CRA)

# Bond Reserve: Current Policy

- Bond covenants specify “reserve requirement”, which can be met by
  - Maintaining cash reserve (current practice)
  - Acquiring “qualified insurance” in the form of a surety bond (proposed change)
- Requirement must be met within 5 year of bond issue
- Current Reserve Requirement: $113.3 million
- Current Bond Reserve balance: $85.5 million

# CRA: Current Policy

- Contingency Reserve of $25 m to be funded from revenue in 2005 and 2006
- Use of Reserve Funds:
  - "…. cover current obligations in any year in which the amount of net revenue available to fund capital requirements is not positive."
- Replenishment of Reserve when used:
  - "Within two years of the withdrawal of funds from the Account, available net revenues shall be deposited in the Account until the targeted balance of $25 million is restored."

# Proposed Changes

- Changes recommended by Advisory Board and supported by Mayor
- Meet full reserve requirement ($113.3 m) immediately by purchasing surety bond
  - Single up-front premium of about $2.5 million
- Transfer balance from Bond Reserve to new Contingency Reserve ($85.5 m)
- Increase balance in CRF through accrual of interest until balance reaches $100 m target

# Rationale for CRA Target Balance

- $100 m -- corresponds to level of cash reserves maintained by high-rated utilities
  - equal to 120-150 days of operating expenses
- $25 m -- when combined with 95% confidence policy, covers contingencies up to 99% confidence, but…
  - experience shows that conditions can be far worse than assumed in our modeling

# Proposed Changes (cont.)

- Specify terms for use and replenishment of Reserve through Charter amendment to be submitted to voters in November 2005
  - Ordinance and Mayoral concurrence required to withdraw funds from Reserve
  - On withdrawal, rate increase required to restore balance in four years
  - Ordinance with 3/4 Council majority and Mayor’s concurrence required to change target balance ($100 m)

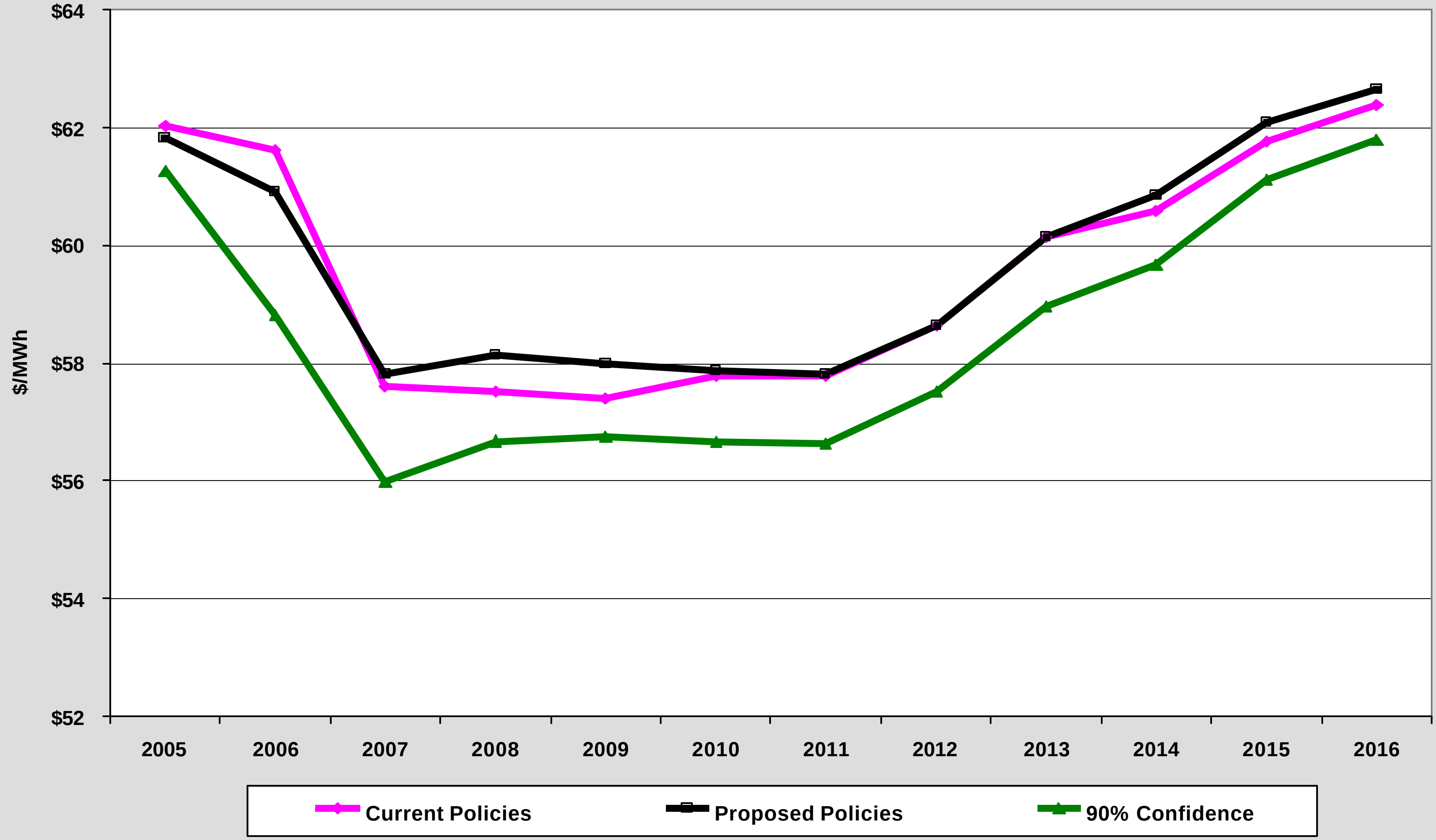
# III. Debt as a % of Capitalization

# Debt as a % of Capitalization

- As of 12/31/04, debt was 84% of capitalization
  - General agreement that this is too high
- 50-60% more common for high-rated utilities
- Reducing debt now preserves the ability to borrow in the future for...
  - possible resource acquisitions
  - unforeseen contingencies

# IV. Comparative Results

# Average System Rate

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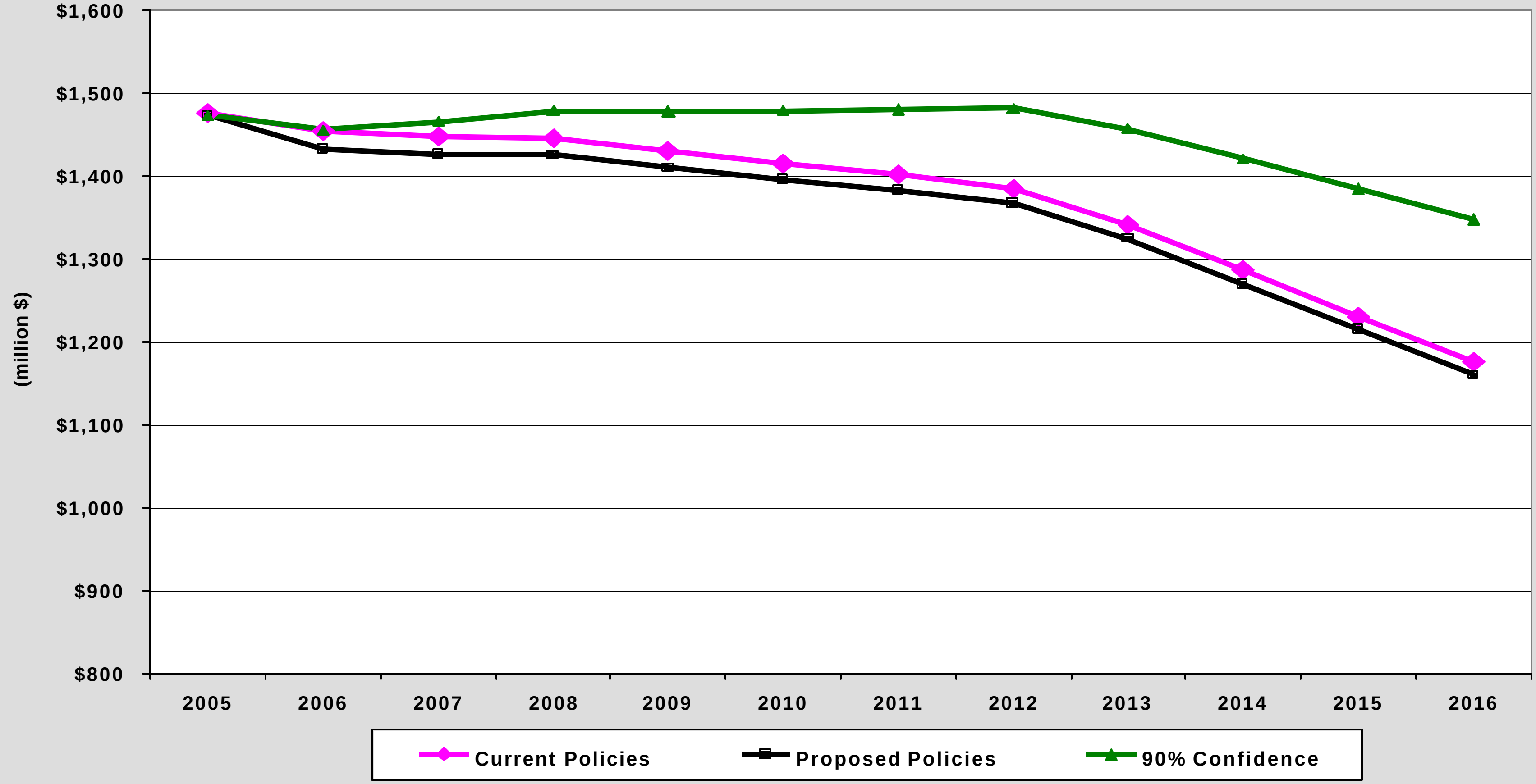
# Average System Rate

- New policies have minor effect on rates
  - Rates are lower in 2006, because of lower deposits to Bond Reserve and CRA
  - Rates are higher 2007-09, because interest earned on CRA is deposited to CRA
- Rates are consistently lower if set to achieve 90% confidence
  - Gap relative to proposed policy diminishes over time.

# Debt Outstanding

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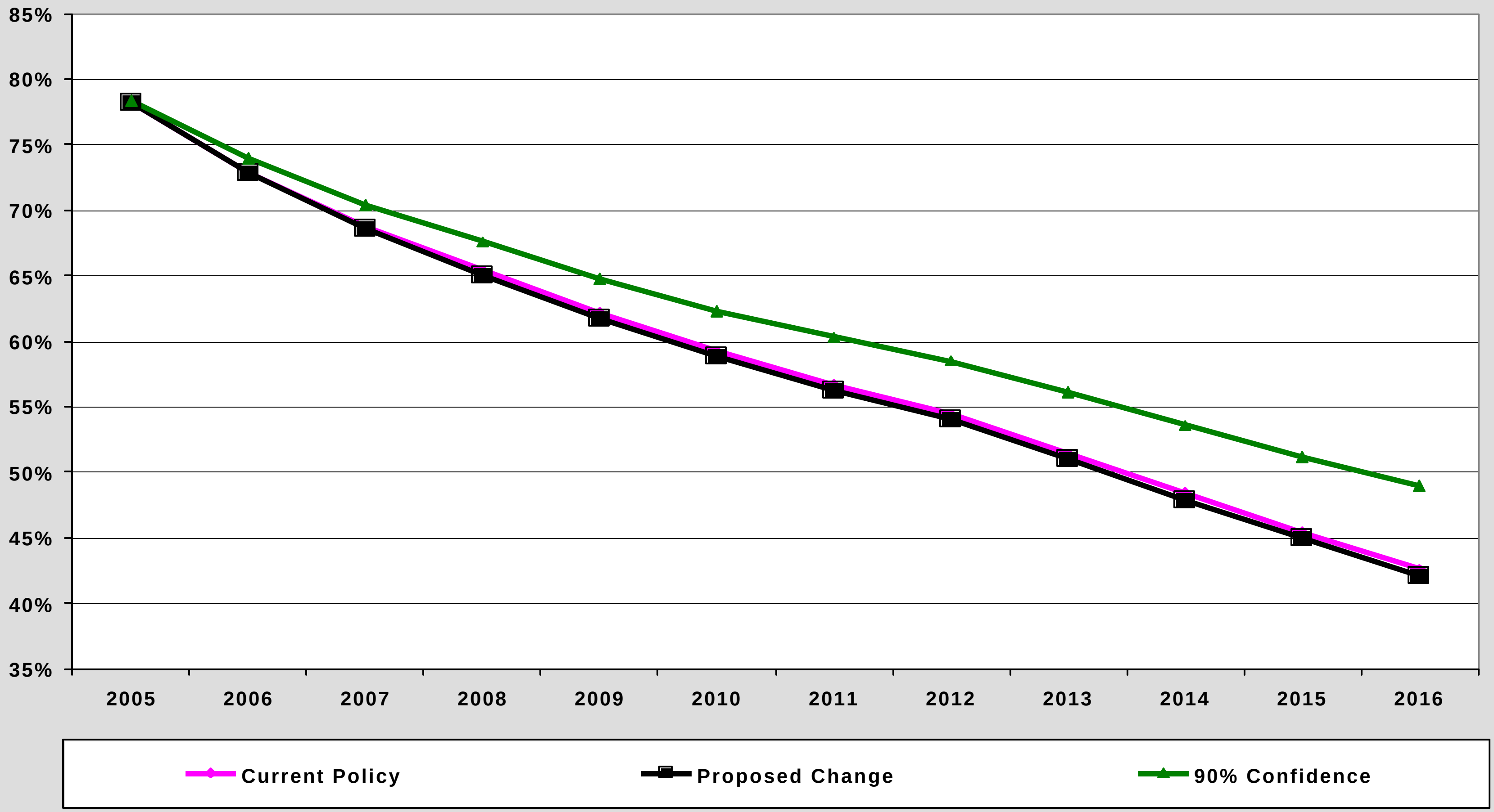
# Impact of Alternative Policies

| | Debt Outstanding ($ millions) | | |
|---|---|---|---|
| | 2005 | 2016 | Change |
| Current Policy | $1,475 | $1,175 | -$301 |
| Proposed Policy | $1,473 | $1,159 | -$313 |
| 90% Confidence | $1,473 | $1,347 | -$125 |

# Debt as a % of Capitalization

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# Debt as a % of Capitalization

- Little difference between existing and proposed policies
  - 57/56% in 2011, 43/42% in 2016
- At 90% confidence, debt is 60% of capitalization in 2011, 49% in 2016